Articles

NEW VALUE, AFTER *LASALLE*

*Nicholas L. Georgakopoulos**

Abstract: The *LaSalle*[1] opinion ended doubts about the continued existence of the new value exception to the absolute priority rule. Reorganization plans that propose to issue securities in exchange for new contributions can be crammed down, but under stricter criteria. After *LaSalle*, new value plans must meet a market test. Thus, *LaSalle* appeared to revolutionize the cram-down process, forcing auctions in every new value plan. This Article surveys the experience since *LaSalle*. The few cases that applied it never ordered an auction or a true market test. Every plan proposed by debtors was rejected. In cases where competing plans were allowed, the choice among them was made by the court rather than any market.

The experience with competing plans indicates that new contributions of unique assets that will serve the debtor's strategy may overcome objections. Pursuing the justification of the fresh start policy, that bankruptcy law will prevent the incapacitation of individuals' productivity, reveals the possibility of a narrow exception to *LaSalle's* requirement of a market test for every new value plan.

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* Professor of Law and John S. Grimes Fellow, Indiana University School of Law, Indianapolis. The author wishes to thank Jay Jaffee and the audience of the Indianapolis Bar Association presentation of this Article for their valuable comments.

[1] Bank of America Nat'l Trust v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 446 (1999) [hereinafter *LaSalle*].

INTRODUCTION

Bank of America National Trust v. 203 North LaSalle Street Partnership is a landmark in reorganization law, giving much needed clarity to the "new value exception."[2] The opinion's outcome was the survival of the new value exception, which agreed with a position taken by this author and cited by the court.[3] The *LaSalle* court heightened the hurdle for the confirmation of a plan of reorganization that utilizes the new value exception (i.e., a plan that calls for the issuance of common stock in exchange for new contributions). This Article revisits the new value exception to examine the impact of *LaSalle*. Contrary to *LaSalle*'s apparent mandate for auctions, no opinions report auctions in such a setting. Instead, a new form of contested confirmations of new value plans appears. This indicates that the pressing need for an improved process for voting on new value plans continues unabated.

Using intervening research that stresses how bankruptcy law revives productivity,[4] this article also identifies a likely exception to *LaSalle*. Exclusive new value plans should be allowed to address the rare cases where the failure of a closely held corporation hamstrings the productivity of the individuals behind it due to exclusive contracts or non-compete obligations that block their capacity to work outside the corporation.

The new value exception is a rule that applies in contested reorganization plans. A plan is contested if it fails to receive approval by every class of impaired creditors. The sequence of events leading to this setting is that a claimant, often the debtor, proposes a plan and one class of impaired creditors do not approve of it by the required majorities.[5] If the plan meets all requirements

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[2] *Id.*

[3] *Id.* at 446 (citing Nicholas L. Georgakopoulos, *New Value, Fresh Start*, 3 STAN. J. L. BUS. & FIN. 125 (1997)).

[4] Nicholas L. Georgakopoulos, *Bankruptcy for Productivity*, 37 WAKE FOREST L. REV. 51 (2002) (stating: bankruptcy law consistently restores productivity that is incapacitated by insolvency); NICHOLAS L. GEORGAKOPOULOS, THE ECONOMIC ANALYSIS OF BANKRUPTCY LAW: AN INTRODUCTION TO ECONOMIC ANALYSIS OF LAW (in Greek, Η Οικονομική Ανάλυση του Πτωχευτικού Δικαίου: Εισαγωγή στην Οικονομική Ανάλυση του Δικαίου, 2000) .

[5] All classes of impaired creditors must approve a consensual plan, according to § 1129(a)(8). 11 U.S.C. § 1129(a)(8) (2003). "With respect to *each class* of claims or interests (A) such class *has accepted* the plan; *or* (B) such class *is not impaired* under the plan." *Id.* (emphasis added). Creditors vote by classes to approve the plan. *Id.* § 1126. Each class must approve the plan with two majorities, with an absolute majority by head count and with a two-

of a consensual plan, listed in § 1129(a) of the Bankruptcy Code,[6] then the court can approve the plan, at its discretion, provided it meets the requirements of § 1129(b), which are: (1) the plan must not "discriminate unfairly"[7] and, (2) it must be "fair and equitable," which includes meeting the "absolute priority rule."[8]

The "absolute priority rule" seeks to preserve the ranking of creditors by seniority.[9] Liens and subordination clauses establish the order in which creditors would be satisfied in a liquidation (i.e., their seniority). The absolute priority rule gives each dissenting class that is not paid in full the right to object against any

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thirds majority by amount. *Id.* "A class of claims has accepted a plan if such plan has been accepted by . . . at least *two-thirds in amount* and more than *one-half in number* . . . ." *Id.* (emphasis added). Impaired creditors are those who are not restored to their position before breach or bankruptcy. *Id.* § 1124.

> [A] class . . . *is impaired* . . *unless* . . . the plan (1) leaves unaltered [its] . . . rights . . . or (2) notwithstanding any . . . provision . . . that entitles . . . [it to] accelerated payment . . . (A) *cures* any such *default* . . . (B) *reinstates the maturity* . . . (C) *compensates* . . . for any damages incurred as a result of any reasonable reliance [on acceleration]; and (D) *does not otherwise alter* [its] . . . *rights* . . . .

Id. (emphasis added).

6 *Id.* § 1129(a).

7 *Id.* § 1129(b)(1). Unfair discrimination captures the notion that a plan cannot treat classes of similarly situated claimants differently without justification. For example, a plan that treats the deficiency claim of the main secured creditor vastly differently from other long-term unsecured claims will fail this test. An ongoing relation, for example, with suppliers justifies different treatment. *See generally* Denise R. Polivy, *Unfair Discrimination in Chapter 11: Comprehensive Compilation of Current Case Law*, 72 AM. BANKR. L.J. 191 (1998).

8 Section 1129(b)(1)-(2) provides:

> (b)(1) [I]f all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan *does not discriminate unfairly, and is fair and equitable,* with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.
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> (2) For the purpose of this subsection, *the condition that a plan be fair and equitable* with respect to a class *includes* the following requirements:
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> (A) With respect to a class of secured claims, the plan provides—
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> (i)(I) that the holders of such claims *retain the liens* securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and
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> (II) that each holder of a claim of such class receive on account of such claim deferred *cash payments totaling at least the allowed amount* of such claim, of a value, as of the effective date of the plan, *of at least the value of such holder's interest* in the estate's interest in such property . . . .

11. U.S.C. § 1129(b)(1)-(2) (emphasis added).

9 *See infra* note 14 and accompanying text.

distribution to a class that is junior to it.[10] The effect of the rule is to block plans that would violate the satisfaction of creditors by rank of seniority. The most senior classes can use the rule to force complete repayment of their claims (these classes are known as being "in-the-money"). Since the debtor is insolvent, inevitably, a class will be only partly in-the-money, and cannot extract enough value for its complete repayment. All classes more junior than this last in-the-money class are necessarily "out-of-the-money" in the sense that they would not receive any value. Imagine that the debtor were liquidated with a single transaction (i.e., the sale of the entire business as a going concern. The proceeds would be exhausted by the in-the-money classes). The absolute priority rule enables the most junior in-the-money class to prevent the out-of-the-money classes from getting value.[11]

The new value exception is either an exception, or a corollary, to the absolute priority rule. The reorganization plan can issue new claims in exchange for new contributions to the reorganized firm.[12] If such claims are issued to junior out-of-the-money claimants, the question arises whether the buyers get more than equivalent exchange. If so, the issuance may be a violation of the absolute priority rule.

This Article proceeds by explaining the background of new value plans in Part II. Part III explores the evolution of the law regarding the absolute priority rule and the "new value exception."[13] Part III.A. discusses the few cases that have tried to apply *LaSalle's* directive for a market test of new value plans. Part III.B. explores the source of the undesirability of new value plans that have not been subjected to a market test, while Part III.C. argues that untested new value plans could be justified to restore the productivity of individuals. The Conclusion explores further

[10] 11 U.S.C. § 1129(b)(1)-(2).

[11] *See id.*

[12] *See infra* note 20 and accompanying text.

[13] Some consider the "new value exception" as a corollary to the absolute priority rule, despite that dominant usage calls it an exception. The question is one of semantics that depends on how the rule of absolute priority is phrased. If it is phrased "creditors who are not fully satisfied are entitled to prevent claimants junior to them from receiving any value in the reorganized enterprise," the new value rule is an exception because it enables junior claimants to receive value. If the absolute priority rule is phrased as "claimants who are junior to creditors who are not fully satisfied cannot receive any value on account of their claims," it is a corollary because the value received pursuant to the proper operation of the new value exception is received on account of the new contribution, not the pre-bankruptcy claim.

avenues for developments of the law in this field, most notably the need for a better scheme for voting on the confirmation of reorganization plans.

I. THE LAW AND ENVIRONMENT OF NEW VALUE PLANS

The environment in which new value plans occur is shaped not only by the law, but also by the coalitions that the reorganization process of the Bankruptcy Code produces. Subpart A explains the law and subpart B explains the coalitions.

A. *Absolute Priority, the New Value Exception, and* LaSalle

Whereas *LaSalle* altered the rule about the new value exception, the existence of the new value exception depends upon the existence of absolute priority. The narration must begin with absolute priority.

The concept of absolute priority flows from the idea that the many different stakeholders in a firm have different rankings, depending on whether they are secured, ordinary, or subordinated creditors, or, finally, equity holders.[14] Creditors' different ranks imply that some must be satisfied before others. If the rank of creditors is violated when the firm's value is being distributed, their priority, and the absolute priority rule, is violated.

The absolute priority rule, as a doctrine of U.S. reorganization law, traces back to *Northern Pacific Railway Co. v. Boyd.*[15] A junior

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[14] 11 U.S.C. § 724(b) (establishing the priority distribution to holders of liens); *see also id.* § 510(a) (stating that the distribution of the assets of the estate must respect subordination agreements).

[15] 228 U.S. 482 (1913). The facts of the case are confused by two railroad failures, Coer D' Alene Railway and Navigation Co., ("Coer") and Northern Pacific Railroad ("NPRroad"), an intervening fraudulent transfer, and the transfer of the claim at bar to Boyd. Boyd's transferor's claim regarded labor and materials provided to Coer in 1886. *Id.* at 484. The fraudulent transfer occurred through a transaction that today would be called a leveraged buyout by NPRroad. *Id.* at 485. The over-leveraged company failed, and was bought in foreclosure by Northern Pacific Railway ("NPRway"), a successor of NPRroad. *Id.* The foreclosure proceeds were exhausted before junior creditors like Boyd were paid. *Id.* at 487. Boyd's attack against the NPRway treated NPRway both as a successor of the transferee of the fraudulent transfer and as a successor of Coer's shareholder. *Id.* at 484. NPRroad was that transferee and that successor. *Id.* Boyd was vindicated under a theory that attacked NPRway as a shareholder (i.e., under the theory that alleged Coer's shareholder received value before Boyd in violation of the absolute priority rule). The new firm (NPRway) issued securities reflecting a market valuation of $345,000,000.00, while only $61,500,000.00 was the winning bid at the foreclosure, and Coer's secured debt was $147,500,000.00. *Id.* at 489-90. The Court

creditor, Boyd, was ignored in a reorganization in which the old equity holders retained a stake in the corporation.[16] This was a violation of the junior creditor's absolute priority (i.e., his right to be satisfied before the old equity holders received any of the failed firm's value), and Boyd's claim survived against the reorganized entity.[17] Creditors can attack distributions of value to claimants junior to them.

The stage is ready for the entry of the new value exception. A reorganization plan that leaves some creditors unsatisfied, issues to the old shareholders some equity in the reorganized firm. The unsatisfied creditors invoke the absolute priority rule against that issuance.

The new value exception arose in a setting much simpler than the several classes of claims contemplated by chapter 11. The dissent of a tiny minority of even the only class of creditors would hold up reorganizations if we were to adhere strictly to the absolute priority rule. Creditors' contractual rights imply that they must all consent to the amendment of their debt's terms in a reorganization. Creditors who challenged this unanimity requirement triggered a Supreme Court opinion by Justice Douglas, who served as commissioner of the Securities and Exchange Commission and is, to this day, one of the most respected corporate and reorganization thinkers on the Court.[18] In *Case v. Los Angeles Lumber Products Co., Ltd.*,[19] Justice Douglas stated that the old equity can participate in the reorganized firm despite the fact that dissenting claims are not satisfied, provided the old equity purchases its participation with consideration of "money or . . . money's worth, reasonably equivalent" to the value received, which is substantial, and necessary for a successful reorganization.[20] This is the new value exception.

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noted that the foreclosure was in effect a reorganization of Coer, in which the senior creditors and the equityholders split the value of the firm, while dissenting junior creditors were not paid in full. *Id.* at 503-06. "[I]f . . . a single creditor was not paid, or provided for in the reorganization, he could assert his superior rights against . . . the old stockholders in the property transferred to the new company." *Id.* at 504.

[16] *Id.* at 487.

[17] *Id.* at 510.

[18] *See, e.g.*, Randolph J. Haines, *The Unwarranted Attack on New Value*, 72 AM. BANKR. L.J. 387, 411 (1998).

[19] 308 U.S. 106 (1939).

[20] *Id.* at 122. The debtor corporation's only asset was L.A. Shipbuilding and Drydock Corp., which had under $1,000,000.00 of assets securing over $4,000,000.00 of debt to bondholders. *Id.* at 109. In 1930, the debtor and ninety-seven percent in value of the

The simplicity of the facts of *Los Angeles Lumber* may argue for a narrow reading of the exception. There was only one class of creditors, and ninety-seven percent (in value) of those agreed with the 1930 reorganization.[21] The dissenters were so few they seem to hold up the reorganization using absolute priority as a tool. The new value exception may seem intended only to counteract their hold up power but the new contribution it required also meant that absolute priority was preserved.

Even without the exception, the old equityholders could have participated in the 1930 reorganization of *Los Angeles Lumber*. Selling equity securities to the old managers could take place after the reorganization was complete. This would imply that creditors would have received the firm's residual value and would have become shareholders. But the same result could be achieved by having the reorganized firm merge with a shell corporation formed by the old equity holders where, according to the merger agreement, the reorganized firm's shareholders (the old debt holders) would exchange their shares for debt in the merged corporation.[22] A group with majority (i.e., the creditors who support the reorganization plan) could implement this transaction. The fact that in *Los Angeles Lumber* the restructuring plan garnered the support of the overwhelming majority of the only class of creditors supports the new value exception. The same majority would be able to produce the same outcome after a reorganization.

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bondholders entered into a restructuring agreement, according to which the old shareholders put new value into the enterprise and in exchange were released from liability and received new common stock. *Id.* Nevertheless, the debtor failed again and went into reorganization in 1937. The 1937 plan created only two classes of securities, common and preferred stock. *Id.* at 110. The bondholders received most of the preferred (some would be sold to raise working capital) and the original shareholders got the common. *Id.* The going concern value was $830,000.00, of which $811,000.00 would be received by the bondholders, constituting approximately twenty-five percent of their claims. *Id.* at 112. Almost ninety-three percent of the bondholders (in value) consented to the plan, as did virtually 100% of the old equity. *Id.* at 110. But the old equityholders received their new equity stake without tangible contribution of new value. *Id.* Dissenting bondholders claimed that this type of reorganization was not within the "fair and equitable" requirement of the old Bankruptcy Act. *Id.* at 112. The Court agreed, and Justice Douglas stated the conditions under which equity may participate in reorganizations, a rule that has since been followed as the new value exception. *Id.* at 132.

[21] *Id.* at 109-10.

[22] *See, e.g.*, Del. Gen. Corp. L. § 251(b) ("The [merger] agreement shall state . . . the manner of converting the shares of each [merging corporation] into shares *or other securities* . . . [of the resulting corporation] . . . .") (emphasis added).

Therefore, no essential change was effectuated by the adoption of voting for plans.[23] A plan approved by all classes but one, that must satisfy § 1129(b) and absolute priority, may be supported by the absolute majority of the creditors who would be the post-reorganization shareholders. From this perspective, the new value exception economizes corporate procedure (i.e. the corporate restructuring immediately after the reorganization that would be necessary to issue equity to the old management).

Some doubts arose about the continued survival of the new value exception.[24] Those were extinguished by the *LaSalle* opinion, which created a new requirement for the approval of new value plans. Rather than allowing the judicial determination of the adequacy of the consideration, *LaSalle* imposes a market test:

> [I]t would, of course, be a fatal flaw if old equity acquired or retained the property interest without paying full value. It would thus be necessary for old equity to demonstrate its payment of top dollar, but this it could not satisfactorily do when it would receive or retain its property under a plan giving it exclusive rights and in the absence of a competing plan of any sort. Under a plan granting an exclusive right, making no provision for competing bids or competing plans, any determination that the price was top dollar would necessarily be made by a judge in bankruptcy court, whereas the best way to determine value is exposure to a market.[25]

In other words, the new value exception exists, but its use is conditioned by competition that will ensure that the new value plan does not give securities in the reorganized company of value greater than the consideration paid. Thus, *LaSalle* requires a market test for the approval of new value plans, and points to either competing reorganization plans or an auction of the equity stake to be issued.

While the competition requirement might not seem a major change, it is. Before *LaSalle*, new value plans routinely gave the right to buy the new equity to specified buyers. If a plan gave the old equityholders the right to buy equity in the reorganized firm,

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[23] *See* 11 U.S.C. § 1126 (2003); *supra* note 5 and accompanying text; *infra* note 30; *see* Kevin A. Kordana & Eric A. Posner, *A Positive Theory of Chapter 11*, 74 N.Y.U. L. REV. 161 (1999) (discussing the information and voting problems of chapter 11).

[24] *See* Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting, 908 F.2d 1351 (7th Cir. 1990).

[25] *LaSalle*, 526 U.S. 434, 457 (1999) (footnote omitted).

that right tended to be exclusive. No other buyers were allowed to outbid the old equityholders. Such plans would violate *LaSalle.*

To understand the new value exception, understanding *LaSalle* is not enough. It is important to recognize that the law influences group dynamics by requiring the existence of specific coalitions.

B. The Coalitions

Disputes about new value plans have two counter-intuitive features. New value plans are only viable if equityholders have the support of one creditor class. This also implies that the supporting class has confidence in the management team.

1. The Equity-Creditor Alliance

The dispute over a new value plan involves at least three groups, two of which must form a coalition. The three groups are the equityholders who propose the plan, the class that opposes the plan, and the class that must support the plan. New value plans tend to be proposed by the debtor (i.e., the board of directors that the old equityholders' elected, during the exclusivity period).[26] A new value plan is only contested if it fails to be approved by every impaired class.[27] Therefore, at least one class must fail to approve the plan. The plan must meet all remaining criteria of § 1129(a) except approval.[28] One requirement is that one class of creditors must favor the plan.[29] The plan must entice one class of creditors to support it. By implication, the one supporting class also agrees to the issuance of new equity under the plan's terms.[30]

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[26] The debtor has the exclusive right to propose a plan during the first 120 days after filing and if a plan is submitted, no competing plan may be filed in the first 180 days. 11 U.S.C. § 1121.

[27] *Id.* § 1129(a) ("The court shall confirm a plan only if all of the following requirements are met: . . . (8) With respect to each class of claims or interests (A) such class has accepted the plan; or (B) such class is not impaired under the plan.").

[28] *Id.* § 1129(b)(1). ("[I]f all of the applicable requirements of subsection (a) . . . other than paragraph (8) are met with respect to a plan, the court, . . . shall confirm the plan . . . if the plan does not discriminate unfairly" and follows absolute priority.).

[29] *Id.* § 1129(a) ("The court shall confirm a plan only if all of the following requirements are met: . . . (10) If a class of claims is impaired . . . at least one class . . . that is impaired . . . has accepted [it] . . . .").

[30] One of the requirements for confirmation of a non-consensual plan is that at least one impaired class does approve it. *Id.* § 1129(a)(10) ("If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan,

The support and opposition to the plan among classes triggers the absolute priority rule. Unless the opposition is a dissenting class, the plan is a consensual one, approved under § 1129(a) and need not satisfy the requirements of § 1129(b), which include the absolute priority rule.[31] Dissenting creditors that are only a minority of a class receive the lesser protection of § 1129(a)(7), which requires that they receive no less than they would in a liquidation.[32] Despite the lonely dissent of a few believers in the constant perfection of markets,[33] liquidation value can be much less than reorganization value.[34] Consider as an example, the case of a reorganization during a crisis that causes bids for the firm to be at sixty percent of its going-concern value, and for its assets at fifty percent. If the firm has senior debt obligations equal to sixty-five percent of its going-concern value, a junior creditor would not receive any value in liquidation. The junior creditor who is in the dissenting minority of a consenting class, is not entitled to any value, regardless of the plan's allocation of value to the old equity. Receiving the protection of the absolute priority rule makes a big difference. If the class that includes the junior creditor dissents, then it is entitled to thirty-five percent of the reorganized firm's value before any value is distributed to the equity.

In the typical case, the equityholders are out-of-the-money and would receive nothing in a reorganization. The ownership stake they buy using the new value plan usually carries control of the

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determined without including any acceptance of the plan by any insider.").

[31] *Id.* § 1129.

[32] *Id.* § 1129(a)(7). This section requires that:

> With respect to each impaired class of claims or interests (A) each holder of a claim or interest of such class (i) has accepted the plan; or (ii) will receive or retain under the plan on account of such claim or interest property of a *value, as of the effective date of the plan,* that is not less than the amount that such holder would so receive or retain *if the debtor were liquidated* under chapter 7 of this title on such date . . . .

Id. (emphasis added).

[33] The principal example is Douglas Baird, who argues that reorganization law should be substituted by a system of forced auctions of the enterprise as a going concern. Douglas G. Baird, *The Uneasy Case for Corporate Reorganizations,* 15 J. LEGAL STUD. 127, 141 (1986) (favoring elimination of chapter 11); *see also* Douglas G. Baird, *Revisiting Auctions in Chapter 11,* 36 J.L. & ECON. 633 (1993).

[34] The imperfections of actual markets mean that the sale of assets, or of the firm, could produce proceeds that are significantly less than the value of the reorganized firm. *See* Georgakopoulos, *supra* note 4, at 67-78 (explaining how such imperfections imply that a reorganization procedure is necessary).

reorganized entity, but deviations from this pattern are likely. It is conceivable that the equity is in-the-money, but still uses the new value exception to regain control because the plan exchanges debt for equity (motivated, perhaps, by a desire to produce the safety of a firm with low debt-to-equity ratio). Yet another possibility is that the new value exception is used to give management a stake in the firm that ensures management's commitment to the reorganized firm, without giving management control. For example, a plan proposed in September 2002 for the reorganization of Sunbeam, required Jerry W. Levin, Sunbeam's Chief Executive Officer, to acquire a small equity stake for $3,000,000.00.[35]

2. *Confidence in Management*

A likely implication of the support for the plan of one class of creditors, is that they have confidence in the resulting management team. Indeed, the seminal cases on the absolute priority rule and the new value exception concern the validity of the distribution of equity to the old equity-holders who were also managers.[36] The interest of creditors in the old management is not surprising since it serves them regardless of their position after the reorganization. Creditors, who are converted into equityholders under the plan, naturally want to see the firm prosper. Even if they retain their capacity as creditors, they still have every interest in having the firm prosper and service their claim.

II. NEW VALUE AFTER *LASALLE*

LaSalle established the rule requiring competition as a condition of the use of the new value exception, in an environment where the equity must form a coalition with a creditor class that has confidence in management. The brief experience with the new rule is instructive about its functionality.

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[35] Martha Brannigan, *Sunbeam's Reorganization Plan Will Change, in Bid to Cut Debt,* WALL ST. J., Sept. 8-9, 2002.

[36] *See supra* notes 14-25 and accompanying text for a discussion of the origins of the absolute priority rule.

A. *The Post-*LaSalle *Experience*

Paradoxically, the experience after *LaSalle* does not include any report of an auction or other method of a choice by the market. Several cases are inept attempts that should offend the courts, such as the pretense that the market test is met due to the arm's length nature of a sale of the equity to the debtor's controlling shareholder's daughter,[37] or to a new corporation, organized by the debtor's shareholders.[38]

The cases that involve a colorable argument about the plan's validity, still do not lead to a true market test. Instead of a market test, in the one case that appears to have competing plans, the choice between them is made by the court.[39] By contrast, where creditors asked the court to order an auction, the court refused.[40] Even individual debtors have attempted to use the new value exception since *LaSalle*.[41] While in the case of corporate debtors the new value is external to the corporation, in an individual bankruptcy, unless the new value is a gift, its source is either the estate—in which case it is not new, as in the case of borrowing against assets of the estate—or postpetition income. One court considered *LaSalle* applicable to reorganization plans of individuals, requiring a market test for new value plans.[42]

The way in which courts assess new value plans has changed qualitatively. Before *LaSalle* the courts expended much effort in verifying that the new value plan would meet the *Los Angeles Lumber* criteria of being "new," "in money or money's worth," "substantial," "necessary," and "reasonably equivalent." While the market test seems to only address the last factor, it has dominated the others. The criteria of *Los Angeles Lumber* might have been used to test a plan's realism and the market test may force a realism that obviates unrealistic plans and trivializes the old criteria. For example, a plan may propose a contribution that is unnecessary for the reorganization. The wasteful use of the new contribution makes this plan likely to fail a market test.

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[37] *In re* Global Ocean Carriers Ltd., 251 B.R. 31 (Bankr. D. Del. 2000).

[38] *In re* CGE Shattuck, L.L.C., 1999 B.N.H. 46 (Bankr. D.N.H. 1999).

[39] *In re* Situation Management Systems, Inc., 252 B.R. 859 (Bankr. D. Mass. 2000).

[40] *See generally In re Global Ocean Carriers Ltd.*, 251 B.R. 31.

[41] *In re* Davis, 262 B.R. 791 (Bankr. D. Ariz. 2001).

[42] *Id.*

B. *The Substantial Nature of Contributions*

The pre-*LaSalle* experience with the substantial nature of the new contribution is illustrative. An insubstantial contribution would produce an excessively leveraged reorganized company, where the creditors would bear much of the risk. A requirement that the contribution be substantial perhaps could avoid this type of abuse but was rarely applied to this end. Often courts would reject new value plans by weighing the substance of the contribution, not compared to the value of the reorganized firm, but compared to the total unsecured claims.[43] This metric, of course, is irrelevant for the viability of the reorganized entity and the propriety of the plan. By forcing distributions to out-of-the-money creditors, this application of the requirement that the contribution be substantial, actually aggravated the violation of absolute priority. Plans that gave more value to out-of-the-money junior creditors were more likely to succeed than plans that observed absolute priority. To the extent that *LaSalle* cures this frequent erroneous application of the *Los Angeles Lumber* test, it is a major improvement.

C. *The Necessary Nature of Contributions*

While studying the post-*LaSalle* plans, one should not overlook two new value plans that were confirmed shortly before that decision.[44] They stand out because most plans follow a paradoxical form. In most new value plans, the new value is distributed to creditors, and often that distribution may be the inducement to

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[43] Several cases decided shortly before *LaSalle* elaborate the requirement that the contribution be substantial. *See In re* ARC Water Treatment, 1998 Bankr. LEXIS 1300, at *15-16 (Bankr. E.D. Pa. Oct. 1998) ("In determining whether an equity holder's capital contribution is substantial, courts generally consider . . . the size of the contribution; its relation to the amount of unsecured claims against the estate; its relation to the plan's distribution to unsecured creditors; its relation to the amount of pre-petition claims . . . ."); *In re* Pocono Springs Company, 1998 Bankr. LEXIS 349 at *11 (Bankr. E.D. Pa. Mar. 1998) ("In making the determination of whether a new value contribution to a plan of reorganization is substantial . . . we have considered two factors: (1) whether the proposed payments under the plan represents the best efforts of the partners or insiders of the debtor; and (2) the percentage of the return on creditor's claims relative to the contribution."). The interpretation of "substantial" as requiring the "best efforts" of the new equityholders allows out-of-the-money creditors to block a reorganization plan with a $50,000.00 contribution by top management. *See id.* at *13-14.

[44] *In re* Beauchesne, 209 B.R. 266 (Bankr. D.N.H. 1997); In the Matters of Treasure Bay Corp., 212 B.R. 520 (Bankr. S.D. Miss. 1997).

support the plan. As was explained previously, distributing the new value to creditors violates absolute priority and does not make sense if we believe that they are entitled to no more than the value of the enterprise to which they lent. The distribution of new value is additional value, beyond what creditors are entitled to under any understanding of bankruptcy principles. Nevertheless, all pre-*LaSalle* plans distributed the new funds to creditors.[45] The necessity of the contribution was routinely upheld because the plan would also use the new funds to make distributions and pay expenses. Paying expenses and making distributions provides no information about the possibility of reorganizing without the new funds. The application of the necessity requirement of *Los Angeles Lumber* was irrelevant to whether the contribution was truly necessary in order to effectuate the reorganization of the debtor. If the value of the debtor would increase more from the contribution than the cost of the contribution, any owner would make the cash contribution. If the contribution was not in cash, however, the possibility arises that the owner of the contribution is the sole entity that can acquire the equity in a new value plan. This is illustrated in the two cases that preceded *LaSalle* that do not have monetary contributions in their new value plans.

The notable exceptions were the two plans where the new value was real estate.[46] The *Beauchesne* case involved an individual's new value plan.[47] In an estate of a few million dollars, the contribution consisted of $30,000.00 in cash and of a parking lot valued at $15,000.00, both contributed by the debtor's wife.[48] The *Treasure Bay* plan was much more substantial, involving a casino with a value of $35,000,000.00,[49] and new contribution of $4,500,000.00 in cash and $4,500,000.00 in real estate.[50]

The *Treasure Bay* case, stripped of some detail, involved Treasure Bay Corporation which borrowed $115,000,000.00 and

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[45] *See* Georgakopoulos, *New Value, Fresh Start*, *supra* note 3, at 151-55.

[46] *In re* Beauchesne, 209 B.R. 266; In the Matters of Treasure Bay Corp., 212 B.R. 520.

[47] *In re Beauchesne*, 209 B.R. 266.

[48] *Id.* at 269.

[49] Alternative valuations included $23,000,000.00 by the expert of the opponent of the plan, and $53,000,000.00 according to the expert of a creditor supporting the plan who used an 11.5% discount rate to value the casino. In the Matters of Treasure Bay Corp., 212 B.R. at 544.

[50] *Id.* at 525.

granted first liens in all assets to secure its indebtedness.[51] It was also indebted to ongoing service providers and to other unsecured creditors.[52] The most vocal unsecured creditors were Anderson, a construction contractor, and Santa Fe, a terminated casino management company.[53] The value of the debtor's business was estimated at $35,000,000.00, and two competing plans were filed, one by the equity supported by the secured creditor, First Trust, and a second by Santa Fe, supported by Anderson.[54]

Under the debtor's plan, the secured creditor would keep the lien and a note for $27,250,000.00, waive the unsecured deficiency claim of the secured creditor, pay the ongoing service contractors 100%, and give ten percent of the equity to the secured creditor.[55] With a $9,000,000.00 contribution the old equity would buy ninety percent of the equity in the reorganized firm.[56] The $9,000,000.00 was new contribution, half in cash and half in real estate.[57] The plan also provided an option for the reorganized debtor to purchase more real estate, an election to make five $432,000.00 debt payments as "payments-in-kind" by issuing more debt, and the ability to borrow $2,250,000.00 more from First Trust.[58]

The Santa Fe plan would give new first mortgage notes to the secured creditors with a value of about $20,000,000.00, pay contractor's (allegedly secured, but out-of-the-money) claims $6,000,000.00, and issue new equity in exchange for $10,000,000.00 in cash.[59] Unsurprisingly, the court found that the plan was unfair

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[51] *Id.* at 526.

[52] *Id.* at 525.

[53] *Id.* at 526-27.

[54] *Id.* at 525, 535.

[55] *Id.* at 524.

[56] *Id.*

[57] *Id.*

[58] *Id.* at 538-39.

[59] *Id.* at 535. The opinion does not specify the additional payments that the plans would make. If both plans distributed all the cash, the remaining value of the reorganized enterprise according to the debtor's plan would be higher by the $4,500,000.00 of the real estate contribution. *Id.* at 545. We can estimate the total "liabilities and equity" of the resulting balance sheet by keeping in mind that the only significant debt would be to First Trust. Adding to the equity the $27,250,000.00 obligation to First Trust, produces a total of $37,250,000.00. If the asset side of this hypothetical balance sheet contains matching values, then we can also simulate the one corresponding to the Santa Fe plan. A subtraction of the contributed real estate, leaves the Santa Fe plan with a debtor with assets of $32,750,000.00, with $26,000,000.00 of secured obligations, and remaining equity of $6,750,000.00 for which the plan proponents pay $10,000,000.00. Rather than appearing as an unappealing bargain,

to First Trust and rejected the plan.[60] As an additional source of unfairness, the court discussed Santa Fe's purchase of unsecured claims at 100%, while they could not receive a 100% distribution.[61] The plan was also held to discriminate unfairly against the deficiency claim of First Trust, to which it paid nothing.[62]

The striking difference of *Beauchesne* and *Treasure Bay* from every other new value case, is that they do not distribute the real estate contributions to the prepetition creditors. Thus, these contributions actually function as contributions even when seen from the side of the reorganized debtor, unlike every cash contribution which is used to pay prepetition claims. The *Treasure Bay* case is also remarkable in the importance of the real estate contributed for the reorganization of the debtor. The court noted the increased competition in the area, and that the contributed real estate would connect the casinos and enable the debtor to upgrade its facilities to face the competition.[63]

The experience of a post-*LaSalle* "market test," decided by the court choosing between competing plans, combines with the pre-*LaSalle* experience of the soundness of real-estate contributions. The combination suggests that the contribution of unique tangible property that is important for the operation of the debtor may hold the key to a successful contest between plans. Indeed, the contribution of cash can arguably never be "necessary" for the reorganization of the debtor. If the cash is distributed to the creditors it violates absolute priority. If the cash is used to pay operating expenses, the debtor is not profitable as an independent entity, and is likely to become insolvent again, thus failing the corresponding test of § 1129(a)(11).[64]

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we must realize that the plan proponents also receive the secured treatment of $6,000,000.00 of claims. Excluding the $6,000,000.00 repayment, their net contribution is $4,000,000.00. Receiving $6,750,000.00 in exchange for it does indeed correspond to a bargain.

[60] *Id.* at 546.

[61] *Id.*

[62] *Id.*

[63] *Id.* at 530-31.

[64] 11 U.S.C. § 1129(a)(11) (2003). This section requires that "[c]onfirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan." *Id.*

D. The Undesirability of Untested New Value Plans

Labeling a type of new value plan as "abusive" is conclusory because the label neither reveals its consequences nor evaluates them. Interpretations of the new value exception may allow certain types of plans. The desirability of an interpretation depends on the consequences of the plans that turn on it. If a type of plan does not diminish social welfare, it is difficult to argue that the interpretation that allows it is undesirable. That a type of plan does reduce social welfare supports an interpretation precluding such plans. The typical "abusive" new value plan would have negative consequences, because it would impose costs on lenders without producing larger gains for borrowers.[65] A new value plan without a market test would give control to the equityholders and let them try their entrepreneurial luck again, to test one more business idea. The lack of a market test may also burden the firm with too much debt or render it insolvent. In the rare cases where the equityholders' new business attempt succeeds, the debt is fully satisfied. In most cases, additional funds will have been expended in the additional gamble with the result that a subsequent liquidation would produce less value for creditors. Such permissive use of the new value would reduce the satisfaction of lenders' claims leading to greater interest rates with no countervailing benefit.

An example illustrates the waste. Suppose that debtor corporation is insolvent in both the balance sheet and cash flow sense. Its assets produce earnings of $1,000,000.00 per year, meaning that, if the appropriate discount rate is ten percent, then the firm has a value of $10,000,000.00 as a going concern. The same assets sold in liquidation would produce $5,000,000.00. A credit crunch hampers bidders for the entire firm, making reorganization clearly desirable. The insolvency means that the creditors should obtain *all* the value of the debtor. Instead, the old equity holders propose a new value plan according to which, for a payment of $100,000.00 which is spent on expenses they obtain 100% of the equity in the reorganized firm, subject to debts to creditors with a face value of $10,000,000.00. The new financial structure contains a paradox. The firm is still worth $10,000,000.00, making it impossible that debtholders receive 100% of the firm's value. The

[65] This is the standard method of assessing bankruptcy interpretation. *See, e.g.*, Georgakopoulis, *supra* note 3, at 147-56.

equity cannot have no-value. The equity must have some value not only because the old equity holders were willing to buy it, but also because it can only gain from future uncertainty. Debtholders experience the opposite effect, since they can only lose from uncertainty.

Prospective lenders react to the prospect of receiving less than $10,000,000.00 in liquidation by reducing their willingness to lend. Charging higher rates could compensate for this risk, perhaps even for the exposure to repeated new value plans. The higher rates hamper business creation, however. Society gives up the creation of new businesses (and additional national product) in exchange for not changing the controller of an existing business. Since society experiences no gain by keeping the original controller, it gives up growth potential for no compensating reason. Such bankruptcy law would be a recipe for economic stagnation. The sequences of cases that culminate in *LaSalle* are desirable.

E. Mobilizing Productivity of Individuals

In examining the consequences of bankruptcy doctrine, we must not forget the effect on individuals. The leading case justifying the fresh start policy, *Local Loan v. Hunt*,[66] justifies the fresh start as a measure against pauperism and idleness.[67] Essentially, individuals under crushing debt have no incentive to be productive because their productivity only benefits creditors. The fresh start restores their productivity incentives.

If prohibiting new value plans causes pauperism and idleness, an argument in favor of new value plans is formed. The typical new value case does not leave room for such an inference. If the debtor firm is owned by passive investors, who are not involved in its management, the passing of control imposes pauperism on no

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[66] 292 U.S. 234 (1934).

[67] *Id.* at 245.

> From the viewpoint of the wage earner there is little difference between not earning at all and earning wholly for creditor. Pauperism may be the necessary result of either. . . . The new opportunity in life and the clear field for future effort, which it is the purpose of the bankruptcy act to afford the emancipated debtor, would be of little value to the wage earner if he were obliged to face the necessity of devoting the whole or a considerable portion of his earnings for an indefinite time in the future to the payment of indebtedness incurred prior to his bankruptcy.

Id.

individual. The creditors will seek to maximize the value of the firm, and if employing the same management team is the way to do that, they will. The equity holders (limited partners) in *LaSalle* were passive investors.[68]

Active involvement in the business by the equityholders does not defeat the above economic analysis. The change in control may leave them without jobs, but it does not destroy their *future* productivity incentives. In some cases, the result of the change of control is an increase of the productivity of the debtor. A representative example is the single-asset real estate firm, owned and run by a clumsy heir who drives it into insolvency. As a real estate manager, the clumsy heir leaves a lot to be desired. Being forced to seek other employment would force the erstwhile manager's labors in what is demanded by the market while the new controller of the real estate would appoint a manager with true managerial skills. The change of control relieves society of the heir's poor management. Rather than destroy wealth by continuing the inept management of real estate, the change of control forces the heir into an activity where she creates value. Rather than immobilize skill, *LaSalle*'s application mobilizes it.

F. Exceptional Cases of Freezing Productivity by Obligations not to Compete

Oddly, the limits of the new value policy are illustrated in a case regarding executory contracts. Ordinarily, the rejection of an executory contract seeks to produce the effects of a breach. Proposals have sought to use the "breach" language.[69] A study of puzzles of rejection case law hints at a latent issue of disabling the productivity of individuals (i.e. the concern behind the fresh start). This arose in the rejection of obligations not to compete.[70]

Debtors who are subject to obligations not to compete cannot avoid them by declaring bankruptcy and rejecting the contract with the clause barring competition. The consequences of rejection are those of a breach, and a breach by the obligor does not convert the

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[68] *LaSalle*, 526 U.S. 434, 438 n.2 (1999).

[69] *See* National Bankruptcy Review Commission Report, General Issues in Chapter 11, Recommendation 2.4.1, *available at* http://govinfo.library.unt.edu/nbrc/report/12chaptl .html (last visited Jan. 7, 2004) ("The concept of 'rejection' in section 365 should be replaced with 'election to breach.'").

[70] *In re* Register, 95 B.R. 73 (Bankr. M.D. Tenn. 1989).

obligations not to compete into a claim for damages.[71] The obligee has an injunction against violations of the non-compete obligation. The injunction survives breaches of the contract by the obligor. The case with which many relate is the bankruptcy filing and rejection attempt by actress Tia Carrere; having a lucrative offer to play for "the A-Team," Carrere sought to avoid the non-compete obligation she undertook as part of her contract to join the cast of *General Hospital*.[72]

Nevertheless, courts allow the rejection of some obligations not to compete. Those rejections tend to match the justifications of the fresh start. The example of the Registers stands out.[73] They were a couple who held a franchise and who in the franchise agreement made a valid promise to the franchisor not to compete after the termination of the relation.[74] In bankruptcy, they were allowed to "reject" the obligation not to compete.[75]

Allowing debtors like the Registers to reject their non-compete obligations has the expected negative effect on creditors, but it also has the effect of restoring the debtors' productivity incentives. If the debtor is inept at the business of the franchise, the franchisor and creditor would benefit from replacing the inept franchisee. If, however, the debtor is skilled but unlucky, the non-compete obligation prevents society from enjoying the product of the debtor's labor. Allowing the rejection of the non-compete obligation means that the debtor will again be able to devote his efforts in the occupation where they are most productive. The rejection restores to the national product the debtor's maximal productivity.

The rejection of obligations not to compete may involve a compromise related to the compromise of the fresh start policy. Just as the fresh start policy imposes costs on creditors but restores debtors' productivity incentives, so the rejection of obligations not to compete imposes costs on obligees but restores the productivity

[71] 11 U.S.C. § 365(g)(1) (2003); *see also* Jesse M. Fried, *Executory Contracts and Performance Decisions in Bankruptcy*, 46 DUKE L.J. 517, 519 (1996) ("[R]ejection is treated as a pre-bankruptcy breach. . . .").

[72] *In re* Carrere, 64 B.R. 156, 157 (Bankr. C.D. Cal. 1986).

[73] *In re Register*, 95 B.R. 73-74.

[74] *Id.* at 74.

[75] *Id.*

of some obligors. New value plans provide a solution similar to rejection in some analogous cases.

G. *Exceptional Cases of Freezing Productivity by Blocking New Value Plans*

Settings related to new value plans can raise issues of restoring individuals' productivity, analogous to *In re Register* and *Local Loan v. Hunt*. New value plans may restore individuals' productivity, while the application of *LaSalle*'s market test would preclude them. A setting that produces this effect is one where one or more individuals conduct an expertise-based business through a corporation to which they have granted obligations not to compete. When the corporation finds itself in bankruptcy, only a new value plan can allow the individuals to continue applying their expertise while also giving creditors a stake in their future. An example illustrates.

As an illustration, consider an expert on an arcane topic, who provides journal columns to magazines through a corporation. The columns might be analogous to columns on wine tasting or the game of bridge. The corporation has exclusive contracts with half the magazines or other publications that may publish such columns. The other half has the same arrangement with the expert's only competitor. The corporation is forced into bankruptcy. The equity, held by the expert, proposes a new value plan. If the *LaSalle* rule were to impose an auction of the equity in the new value plan, the likely buyer would be the competitor. After the competitor acquires the corporation, the competitor will invoke against the expert the obligation not to compete with the corporation. The strict application of *LaSalle* reduces the expert's productive capacity.

A new value plan without a forced auction provides a superior outcome. The expert retains a controlling interest in the firm and can continue applying his expertise. This appears to be a deviation from *LaSalle*, but it is justified due to the effects on individual productivity. Cases threatening the elimination of individual productivity as a consequence of an auction of the debtor's equity, are distinguishable from *LaSalle*.

In summary, *LaSalle* correctly eliminates reorganization plans that use the new value exception in a way that harms society. However, the possibility exists that new value plans are the only means to restore the productivity of individuals for whom the debtor is a corporate front. Such cases should be distinguished from *LaSalle*, a new value plan should be allowed without an auction of the equity.

III. CONCLUSION: RENOVATING THE NEW VALUE EXCEPTION

The puzzle with the new value exception is that it must serve two very different functions. While it must prevent creditors from holding up unlucky entrepreneurs, it must also prevent the perpetual control of failed firms by inept businesspeople. To do both, the new value exception must show two very different faces. A legislative straight-jacket cannot fit both. The courts' equity powers, so important in every other aspect of bankruptcy law, must be relied upon in this area as well. It remains to be seen if *LaSalle* leaves enough room for balancing according to equity. The initial experience of no market tests and no confirmations of debtors' plans will hopefully change, and allow a more nuanced evaluation of the evolution.

The fact that secured creditors are still purchasing unsecured claims at one hundred cents on the dollar,[76] and propose plans that distribute value to out-of-the-money unsecured creditors, indicates that absolute priority is still violated. The requirement that one class must approve any plan forces secured creditors to propose plans that make distributions to out-of-the-money unsecured creditors. Either the cram-down requirement of approval must change to accommodate plans proposed by secured creditors or the voting of all stakeholders must be replaced so as to emulate the voting of the reorganized firm's shareholders (before the new value contribution).

Thus, we could expect a transition toward a regime in which the reorganization must anticipate the reorganized firm's capital structure. After an appraisal of the firm's value as a going concern, the senior creditors would retain the creditor position as far as the usual capital structure in the industry permits. As creditors of the reorganized firm, they would not vote. The senior's deficiency claims, and the progressively next most senior creditors would stand to become the shareholders of the reorganized firm until its value is exhausted, and those should be the only ones voting. More junior

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[76] The secured creditor purchased the claims of all of the out-of-the-money outsider creditors in *In re Waterville Valley Town Square Assoc.* 208 B.R. 90, 93 (Bankr. D.N.H. 1997). The court refused to allow an auction of the equity and rejected the plan. *Id.* at 99-100.

out-of-the-money stakeholders should be excluded. The resulting vote would approximate the vote of the shareholders of a reorganized firm without the new value contribution, and their vote should determine the new value exception just as their vote would determine whether the reorganized firm would perform the equivalent transaction of merging with a shell corporation created by the old equity holders.[77] This scheme would allow negotiated contributions that would be unassailable because they would simulate the non-bankruptcy corporate combination that the new value exception mirrors. A transition to such a voting scheme would effectively end concerns about the new value exception and all the problems that § 1129 raises. The egregious single asset cases would not be reorganizable without the secured creditor's consent because the secured creditor would control the vote.

This austere scheme, however, is only advisable for bankruptcies that are neither part of a bubble and crash cycle, nor bankruptcies that trigger fresh start concerns. For a firm's failure to raise fresh start issues, it must not simply be family owned but the family owners must also face a restriction against applying their skill outside the corporation. Only then does a concern arise about wasting the debtor's potential contribution to economic life. Courts must show great skepticism when approaching fresh start claims in the context of the new value exception, never forgetting that they would be exceeding the conventional venue of the fresh start which is limited to the discharge of monetary debts. The leniency of debt discharge is enough to avoid waste by restoring the production incentives in most debtors. Only if the setting of the failed enterprise is such that the individuals will waste their abilities if the enterprise fails—because they cannot employ their skills, as is the case with debtors having obligations not to compete[78]—will the fresh

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[77] It is important to recognize that the result of the new value plan of giving equity to the old equityholders without first satisfying junior creditors, can be achieved in a two step transaction that obviates the new value exception. First, the reorganized entity emerges from bankruptcy with the senior creditors having control. Then, the senior creditors merge the reorganized firm with a token corporation created by the old equityholders. The old equityholders exchange their shares in the token corporation for shares in the reorganized firm. This equivalence was discussed in Georgakopoulos, *New Value, Fresh Start*, *supra* note 3, at 131 n.16.

[78] Obligations not to compete might be undertaken too easily, pursuant to an overoptimism bias, as explained further in Georgakopoulos, *New Value, Fresh Start*, *supra* note 3, at 159-64. While presently this may be the only obvious market failure that wastes debtors' skills, others may appear. The new value exception can then be used to accommodate

start concerns argue for allowing the family owner to maintain control over the failed firm by virtue of the new value exception.

Therefore, in order to use the new value exception so as to assist the fresh start, the court must not only be convinced of the good faith failure of a family-owned firm and its owners, but also of the waste of the owners' skills. If either the skills or the waste are not in prospect, no reason for an untested new value exception exists, but if the court accepts that the fresh start policy argues for continued control of the firm by this debtor, then the example of *In re Whittaker Memorial Hospital*[79] can be followed.[80] The fresh start motivated untested new value exception provides entrepreneurs a laudable incentive scheme. Since the new value exception will be applied to entrepreneurs that show that they were not simply unlucky but that they are able and in a unique position to use their abilities through their firms, it gives them an incentive to demonstrate that they will excel. Furthermore, it gives them an incentive to invest in education and in customizing their business, in finding niches, and developing and serving new markets. The entrepreneur must show that she will be missed.

Compared with the elaborate and artificial structure of § 1129, these proposal are simple and straightforward. The peculiar and questionable activities that § 1129 have given rise to, such as claims trading, impairment negotiations, and classification games,[81] will be substituted with the substantive efforts on the part of the equity holders to show ability in running the firm and on the part of the creditors to show ability to take control of the firm. Errors are inevitable, but even if the courts are inaccurate in applying these rules, they would be a dramatic improvement over the current jumble of activities around § 1129.

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debtors who suffer from those errors as well.

[79] 149 B.R. 812 (Bankr. E.D. Va. 1993).

[80] *Id.* at 816-17 (approving new value plan); *see also* Georgakopoulos, *New Value, Fresh Start*, *supra* note 3, at 155-59.

[81] *See, e.g.*, Polivy, *supra* note 7.